

MEMORANDUM

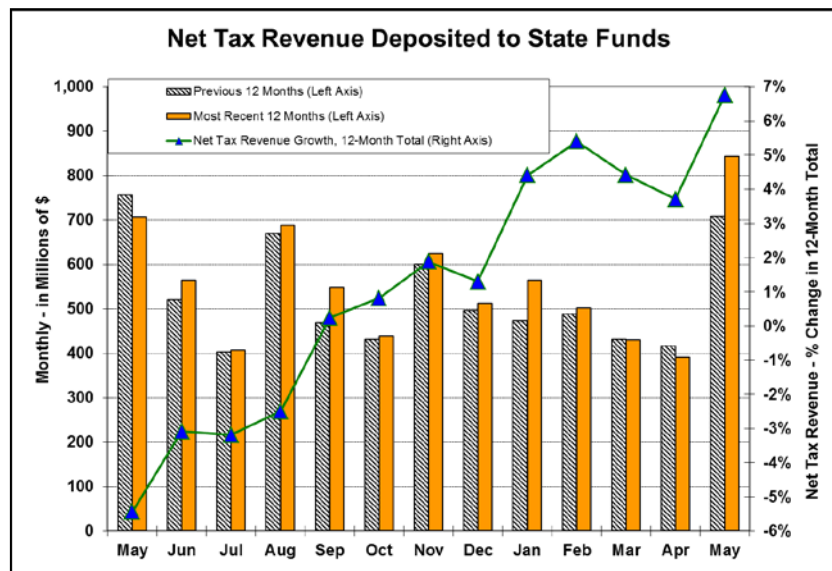
TO: Members of the Iowa Senate and
Members of the Iowa House of Representatives

FROM: Jeff Robinson
Shawn Snyder

DATE: June 28, 2011

Twelve-month Total Net Tax Receipts Through May 31, 2011

The attached spreadsheet presents net tax revenue deposited to State funds for the 12-month period ending May 2011 with comparisons to the previous twelve months. May 2010 to May 2011 one-month comparisons are also presented. The source of the information is the State accounting system, including non-General Fund accounts. All accounting transactions related to taxes remitted to the State were reviewed, along with the refunds issued against those taxes.



Overview of Current Situation

At \$843.2 million, May 2011 net tax revenue was 19.1% higher than May 2010. Three significant issues contributed to the high growth rate this May. First, April 2011 ended on a weekend and that pushed revenue from April into May 2011. Second, tax refunds were issued much faster this year and tax return payments were deposited more slowly, with May 2011 receipts benefiting from both issues. Third, significant corporate tax deposits arrived in May while corporate tax refunds decreased. At \$6.513 billion, annual revenue is now at a level first reached in February 2008 and the total is 3.6% below the November 2008 net revenue peak.

Month of May Comparison

May net tax receipts totaled \$843.2 million, an increase of \$135.5 million (19.1%) compared to May 2010. Major taxes and their contribution to the month's change include:

- Individual Income Tax (positive \$83.0 million, 26.7%) – The timing of tax return processing significantly impacted individual income tax revenue growth for the months of March, April, and May, with faster tax refund issuance and slower tax payment deposits negatively impacting March and April, but providing a significant boost to May net receipts. Over the three months, income tax return payments increased \$71.1 million and income tax refunds issued increased \$32.3 million.
- Sales/Use Tax (positive \$7.1 million, 2.5%)
 - Road Use Tax Fund use tax (fees for new registrations) decreased \$0.9 million, the first negative growth month since April 2010.
 - Gross General Fund sales/use tax receipts increased \$12.0 million while refunds increased \$2.3 million and school infrastructure refunds increased \$1.7 million.
- Corporate Income Tax (positive \$34.9 million, 242.4%) – Gross corporate income tax receipts increased \$26.1 million while corporate refunds decreased \$8.8 million. May's large increase more than offsets a significant decrease recorded in April.
- Fuel Tax (positive \$1.8 million, 5.2%) – A \$2.3 million increase in gross fuel tax deposits was partially offset by a \$0.5 million decrease in fuel tax refunds.
- Cigarette and Tobacco Taxes (positive \$0.1 million, 0.5%)
- Gambling Tax (positive \$0.5 million, 2.2%)

Year-over-Year Comparison – Net Tax Revenue

During the 12-month period ending May 2011, net revenue from all taxes deposited to State funds totaled \$6.513 billion, an increase of \$411.9 million (6.8%) compared to the prior 12 months. Major contributors to the year-over-year dollar and percentage changes include:

- Individual Income Tax (positive \$248.6 million, 9.6%) – At 9.6% growth year-over-year, personal income tax growth has not been this high since April 2008. However, at \$2.845 billion, the level of net individual income tax revenue over the past 12 months is essentially the same as three years ago.
- Sales/Use Tax (positive \$105.0 million, 4.9%) – While sales/use tax revenue is up almost 5.0% over the past year, receipts were \$38.3 million (-1.7%) below the November 2008 peak revenue level.
- Corporate Income Tax (positive \$32.6 million, 15.7%) – May's corporate income tax deposits, net of refunds issued during the month, significantly improved the outlook for corporate income tax revenue. However, at \$240.5 million for the past 12 months, the receipts were two-thirds the level experienced prior to the recession (September 2008 = \$359.2 million).
- Fuel Tax (positive \$5.2 million, 1.2%) – According to Department of Revenue fuel sales reports, over the most recent 12-month period, Iowa taxable gasoline/ethanol gallons sold

increased 4.2% while taxable diesel sales increased 6.5%. Although up year-over-year, taxable diesel sales over the most recent 12-month period are 4.2% lower than the March 2008 peak diesel sales level and total taxable fuel gallons are 1.1% above the August 2007 peak for all gallons sold.

- Gambling Tax (negative \$3.0 million, -1.1%) – According to Racing and Gaming Commission statistics, five of Iowa's 17 casino/track locations reported negative annual adjusted gross revenue (AGR) growth for the 12-month period ending May 2011. The combined AGR growth for the 17 facilities was positive 0.87% over the 12-month period and the data show that annual AGR for the 17 casino/track locations bottomed in November 2010 at \$1.360 billion, 4.6% below the February 2009 peak.
- Cigarette and Tobacco Tax (negative \$0.6, -0.3%)
- Insurance Premium Tax (positive \$21.8 million, 27.8%) – The increase is likely the result of fewer redemptions of tax credits compared to last year.

Tax Spotlight – Franchise (Bank) Tax and Credit Union Tax

The taxation of banks and financial institutions in Iowa dates back to at least 1851. Prior to HF 1294 (Taxation of Financial Institutions Act of 1970), the bank tax was essentially a property tax, collected and retained at the local level.

The current franchise tax (Iowa Code Chapter 422, Division V) is imposed on the net income of state banks, national banking associations, trust companies, federal and state chartered savings and loan associations, financial institutions chartered by the Federal Home Loan Bank Board, and production credit associations at a rate of 5.0%. An alternative minimum tax may be applicable to financial institutions at an effective rate of 3.0%. Credit unions are subject to a different tax discussed below.

The Iowa franchise tax enacted in 1970 provided for rates ranging from 5.0% to 8.0% of net income. The franchise tax rate was reduced to a flat 5.0% in 1980. Prior to 1995, financial institutions could transfer income-producing assets to nonbank subsidiaries reducing the franchise tax owed. Legislation was enacted beginning with tax year 1995 that prohibits the deduction of those types of transfers.

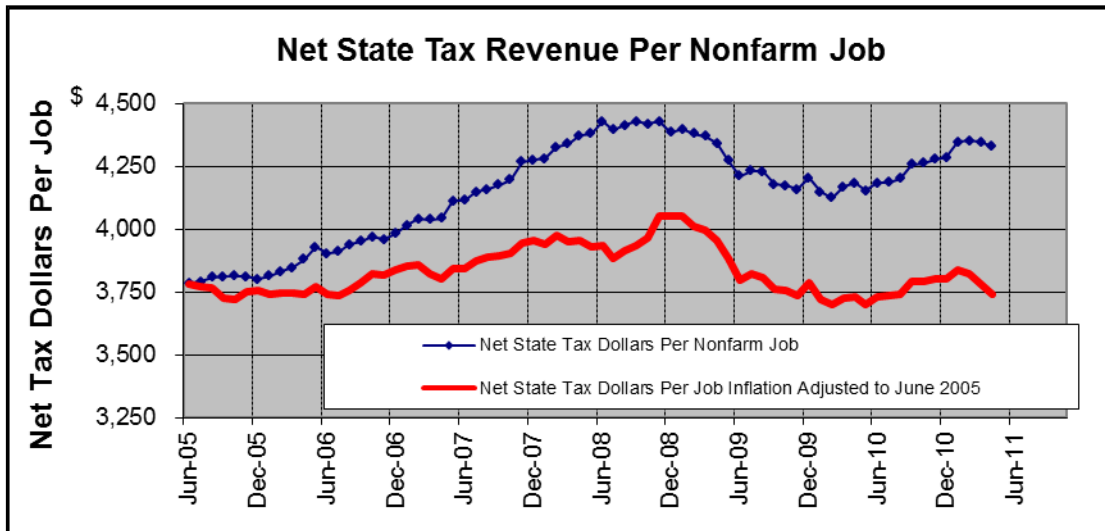
Tax returns for franchise tax are required to be filed by the last day of the fourth month after the end of the tax year. Estimate payments from most financial institutions are due on a quarterly basis. Revenue received from the franchise tax is deposited in the State General Fund.

Credit unions are taxed at a rate of five mills (0.5%) of "legal and special reserves" (see Iowa Code Section 533.329). The tax is imposed by the County Board of Supervisors and the revenue from the tax is divided between the county, city, and State, with the State share equal to 50.0% of revenue collected. The State revenue is deposited to the General Fund.

Tax Revenue and Employment

The average reading for Iowa nonfarm employment over the 12 months ending April 2011 is 1,473,100 and net State tax receipts over the same twelve months totaled \$6.377 billion, or \$4,329 per nonfarm job. This is \$545 (14.4%) higher than the per-job average for the 12 months ending July 2005. Over that same time period, inflation (CPI-U) increased 15.6%. Therefore, State tax revenue per job has slightly trailed the rate of inflation since July 2005. The

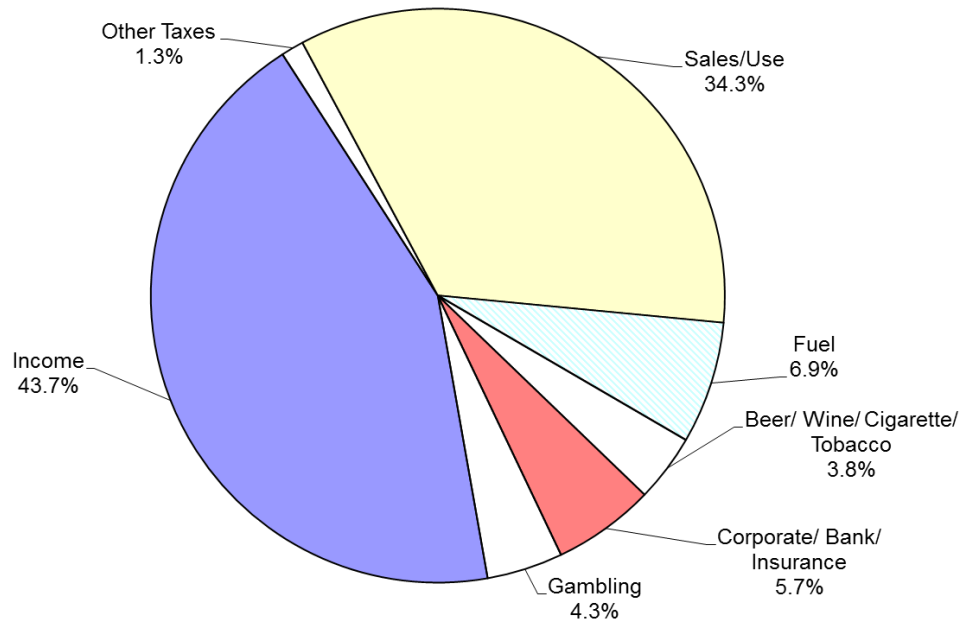
following chart provides a historical perspective of tax collections per nonfarm job and inflation-adjusted tax collections per job.



Net State Tax Revenue - Twelve Months Ending May 2011

Net Revenue = \$6.513 Billion

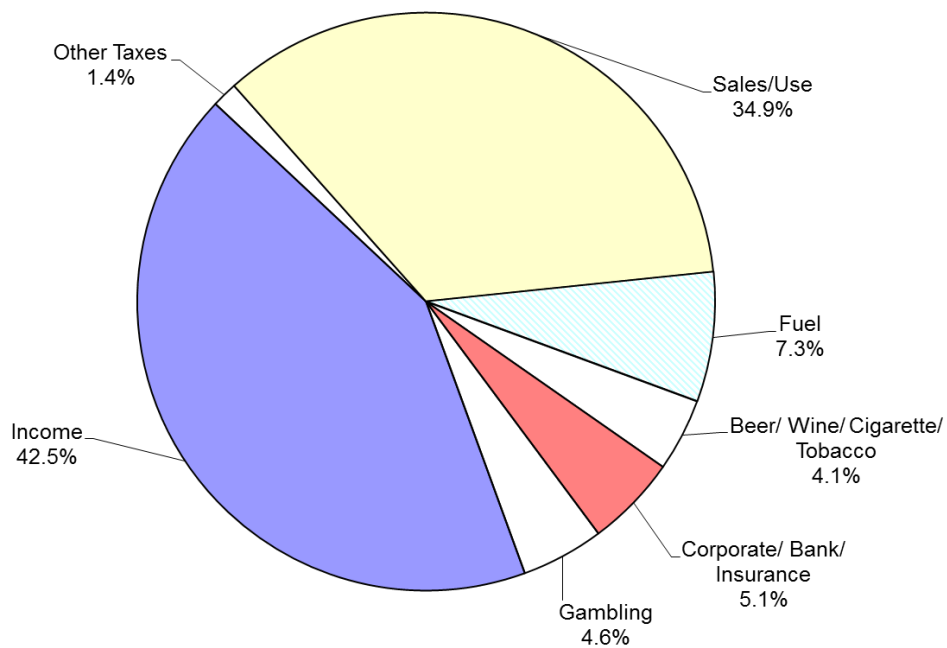
Percentages may not add to 100% due to rounding



Net State Tax Revenue - Twelve Months Ending May 2010

Net Revenue = \$6.101 Billion

Percentages may not add to 100% due to rounding



Net Tax Revenue Deposited to State Funds - Cash Basis

Dollars in millions - Columns and Rows may not add due to rounding

Net Tax by Tax Type	Previous 12-Month Period Total	Most Recent 12-Month Period Total	12-Month \$ Change	12-Month % Change	Month of May 2010	Month of May 2011	May \$ Change	May % Change
Banking	\$ 26.8	\$ 33.0	\$ 6.2	23.1%	\$ 2.1	\$ 6.9	\$ 4.8	228.6%
Beer & Wine	21.2	21.3	0.1	0.5%	1.8	1.7	- 0.1	-5.6%
Cigarette & Tobacco	227.5	226.9	- 0.6	-0.3%	18.3	18.4	0.1	0.5%
Corporate Income	207.9	240.5	32.6	15.7%	14.4	49.3	34.9	242.4%
Fuel	442.8	448.0	5.2	1.2%	34.8	36.6	1.8	5.2%
Gambling	282.0	279.0	- 3.0	-1.1%	23.2	23.7	0.5	2.2%
Individual Income	2,596.0	2,844.6	248.6	9.6%	311.3	394.3	83.0	26.7%
Inheritance	66.3	65.0	- 1.3	-2.0%	4.3	7.1	2.8	65.1%
Insurance	78.3	100.1	21.8	27.8%	15.4	16.1	0.7	4.5%
Other Taxes	8.5	4.5	- 4.0	-47.1%	0.0	0.0	0.0	--
Real Estate Transfer	12.8	14.1	1.3	10.2%	1.2	1.1	- 0.1	-8.3%
Sales/Use	2,131.3	2,236.3	105.0	4.9%	280.9	288.0	7.1	2.5%
Total Net Taxes	<u>\$ 6,101.4</u>	<u>\$ 6,513.3</u>	<u>\$ 411.9</u>	6.8%	<u>\$ 707.7</u>	<u>\$ 843.2</u>	<u>\$ 135.5</u>	19.1%
Gross Tax & Refunds								
Gross Tax	\$ 7,382.9	\$ 7,752.6	\$ 369.7	5.0%	\$ 825.9	\$ 939.2	\$ 113.3	13.7%
Tax Refunds	\$ - 1,281.6	\$ - 1,239.3	\$ 42.3	-3.3%	\$ - 118.3	\$ - 96.1	\$ 22.2	-18.8%
Net Tax Receipts by Fund								
State General Fund (GF)	\$ 5,170.6	\$ 5,553.0	\$ 382.4	7.4%	\$ 622.6	\$ 756.7	\$ 134.1	21.5%
Road Use Tax Fund	\$ 697.3	\$ 730.3	\$ 33.0	4.7%	\$ 61.3	\$ 62.3	\$ 1.0	1.6%
Non-GF Gambling	\$ 214.4	\$ 211.1	\$ - 3.3	-1.5%	\$ 23.0	\$ 23.5	\$ 0.5	2.2%
Other State Funds	\$ 19.1	\$ 18.9	\$ - 0.2	-1.0%	\$ 0.7	\$ 0.8	\$ 0.1	14.3%
Local Option Taxes *	\$ 780.4	\$ 804.8	\$ 24.4	3.1%	\$ 69.0	\$ 73.1	\$ 4.1	5.9%

* Sales, income, and hotel/motel. Distributed to local governments - not included in numbers above.

Numbers are rounded to the nearest \$0.1 million. Percentages are calculated after rounding.

Tax Categories Used in Table

Franchise (Bank) Tax: Taxes on banks are deposited in the State General Fund. State credit union tax is included on this line also.

Beer & Liquor Tax: Taxes on beer, liquor, and wine are deposited in the State General Fund, the Liquor Control Fund, and a small amount is deposited in a Department of Economic Development fund for wine promotion.

Cigarette & Tobacco Tax: Cigarette and the tobacco products tax revenue is deposited in the State General Fund.

Corporate Income Tax: All corporate income tax is deposited in the State General Fund.

Motor Vehicle Fuel Tax: All motor vehicle fuel tax is deposited in one of two road use funds, with the exception of tax revenue from the sale of aviation and marine fuels.

Gambling Tax: Gambling tax is deposited in several State funds, including \$66.0 million per year to the State General Fund. Other funds receiving deposits of gambling tax revenue over the last 24 months include the School Infrastructure Fund, the Rebuild Iowa Infrastructure Fund, the Gambler's Assistance Fund, the County Endowment Fund, the Vision Iowa Fund, and the Revenue Bonds Debt Service Fund.

Individual Income Tax: Most individual income tax revenue is deposited in the State General Fund. A total of \$4.0 million per year is deposited in the Workforce Development Fund. An annual \$2.6 million diversion to the Child Daycare Fund ended in FY 2009. In addition, several economic development programs are financed by individual income tax withholding. In those instances, the employer does not remit the tax withheld from employees and it is never deposited in a State fund. That revenue is not included here.

Inheritance Tax: All inheritance tax is deposited in the State General Fund.

Insurance Premium Tax: All insurance premium tax is deposited in the State General Fund.

Other Taxes: Other taxes include brucellosis eradication property tax (deposited in a Department of Agriculture and Land Stewardship fund), drug stamp tax (State General Fund), utility replacement property tax (State General Fund), and car rental tax (Road Use Tax Fund). Other taxes also include a suspense account used to hold tax deposits prior to determining the correct tax type for the money and tax revenue transferred by the Department of Revenue to separate accounts to fund tax collection activities (tax gap and Department operations).

Real Estate Transfer Tax: Real estate transfer tax is collected by counties. Counties retain 17.25% and remit the remainder to the State. The State deposits 90.0% in the State General Fund, 5.0% in the Housing Trust Fund, and 5.0% in the Shelter Assistance Fund. The distribution of real estate transfer tax revenue changed in FY 2010, when the State General Fund percentage began a decline to 65.0% by FY 2015.

Sales/Use Tax: General sales/use tax is deposited in the State General Fund, while most vehicle use tax is deposited in the Road Use Tax Fund. Beginning FY 2009, the vehicle use tax is now referred to as a fee in the Iowa Code. To allow continuity of data, the revenue from the fee is reflected in this document as tax revenue. Also beginning FY 2009, the School Infrastructure Local Option (SILO) sales tax was converted to a statewide 1.0% sales/use tax and the revenue from that statewide tax is transferred out of the State General Fund monthly through a refund appropriation. To allow for continuity of data, the refund transfers are subtracted from State revenue as part of the net sales/use tax calculation.

Local Option Taxes: Local option taxes are presented at the bottom of the table and are not included in the numbers above. Prior to FY 2009, local option taxes included the SILO tax, Local Option Sales Tax (LOST) for local government finance, Local Option Income Surcharge for schools, and hotel/motel tax. Beginning FY 2009, the SILO tax was converted to a 1.0% statewide tax and the SILO was eliminated. To allow for continuity of data, the transfers from the State General Fund as a result of the 1.0% statewide tax are included in the local option tax amount.

Report Database

The database for this report is the State accounting system. If transactions are incorrectly coded in the system as tax revenue or tax refunds, the numbers presented here will be impacted.